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# STATEMENT TO THE PLENARY BY THE CHAIRMAN OF SPECIAL COMMISSION 3 ON THE PROGRESS OF WORK IN THAT COMMISSION

## I. Organization of work

1. During the 1991 summer session of the Preparatory Commission, Special Commission 3 held nine meetings, i.e., the 143rd to the 151st meeting.

2. Following the usual practice, the Contact Group of the Group of 77 on Special Commission 3 Matters utilized some of the time allocated to meetings of Special Commission 3 for coordination purposes.

3. At the first meeting of the current session Special Commission 3 commenced its consideration of document LOS/PCN/SCN.3/WP.6/Add.7, part X of the draft Regulations on Prospecting, Exploration and Exploitation of Polymetallic Nodules in the Area: Accounting Principles and Procedure. To assist the Special Commission in its consideration of the working paper the Secretariat also had prepared a detailed commentary, contained in document LOS/PCN/1991/CRP.12 on the draft articles of the working paper.

4. It had been proposed at the previous session that it would assist consideration of the working paper if a seminar were held at the onset of the current session at which accounting experts from Governments and intergovernmental organizations could address delegates. Since those experts were not available the seminar was cancelled.

5. At the first meeting of the Special Commission during the current session, the Special Representative of the Secretary-General introduced the working paper. He stated that the draft regulations on accounting procedures had been based on procedures used by several of the largest petroleum companies engaged in petroleum production in Africa, Asia and South America,

as well as a model set of rules prepared in 1981 by the United Nations Centre on Transnational Corporations (UNCTC). The draft attempted to balance uniformity with flexibility so that each contractor could establish its own system, subject to approval by the Authority. That would allow their accounting procedures to fit their operations and be consistent with independent auditing and applicable national laws.

6. The Special Representative of the Secretary-General also stated that the draft regulations were consistent with the conclusions of the Centre on Transnational Corporations and with the International Accounting Standards of the International Accounting Committee which had member bodies in over 70 countries. The draft regulations apply both to the Enterprise and to the contractors.

## II. ISSUES DEALT WITH IN THE SPECIAL COMMISSION

7. After the introduction by the Special Representative of the Secretary-General, the Special Commission commenced its consideration of the working paper with a general exchange of views in the context of a first formal reading. The Special Commission then entered a second phase of consideration of the paper, meeting as an informal working group of the whole. During this phase extensive comments and proposals were made regarding the purpose, scope and provisions of the draft regulations and, rather than their being repeated here, delegations are referred to documents LOS/PCN/SCN.3/1991/CRP.13 and LOS/PCN/SCN.3/1991/CRP.14, which reflect in detail the views expressed by several delegations.

8. The following suggestions were made in an article-by-article discussion of the working paper.

Article 2. Use of terms

9. The view was expressed that the definition of an "Accounting Manual" contained in the article responded more to the needs of a comprehensive accounting system than to those of the type of reporting system contained in the Convention. Another suggestion was to add a new paragraph 4 which would provide that "for the purposes of this Part, 'significant gain or loss' means any total inventory adjustment exceeding a percentage of the total of physical assets or of inventory before adjustment as shall be agreed upon between the Authority and the contractor, in conformity with generally recognized accounting principles."

Article 137. Scope of this Part

10. It was pointed out that Annex III, article 17 (1) (c) (i) did not define the scope and that it had in fact been defined in Annex III, article 13. Furthermore, those accounting procedures should only apply to contractors who had opted for the mixed system, i.e., a combination of a production charge and a share of net proceeds. Another view expressed was that the scope was

limited only to activities under the contract and should be supplemented by additional wording to include financial transactions relating to expenditures incurred prior to commencement of commercial production and which were directly related to the development of the productive capacity of the area covered by the contract and the activities related thereto for operations under the contract.

Article 138. Accounting principles

11. It was pointed out that the draft rules confused accounting regulations and management principles. It was important that accounting principles should be sound; the term "reasonableness of costs" might be acceptable to some but was considered subjective by others and would prove difficult to interpret. The question was raised as to the extent to which the Authority would exercise influence on the management role of the contractor. It was pointed out in that context that it was important not to replace the judgement of miners and contractors with that of civil servants of the Authority. It was therefore proposed that the first paragraph should be deleted and that the article should specify that the accounting should be complete, clear and easy to understand.

12. In support of that argument it was pointed out that the test of reasonableness was not a matter for external bodies. It would be impossible to formulate criteria for reasonableness, and accounting matters were of a factual and not of a subjective nature.

Article 139. Currencies

13. The view was expressed that the article generally reflected current trading practices but as future conditions were unknown it might be better to retain some flexibility as to the choice of currency.

14. It was also proposed that the period in question should be specified so as to avoid gains and losses resulting from transactions. In that regard it was proposed to amend the draft article and to substitute "when payment was made" by "when payment is due" for determining the calculations for gains and losses.

15. On the other hand, it was maintained that the draft regulations were dealing with facts which related to the day "when payment is made" and that the notion of "when the payment is due" should not be introduced in the draft regulations.

Article 140. Accounts and manuals

16. It was proposed to amend the text so that the contractor would not be required to submit the Accounting Manual with other documents. The amendment should further refer to a comprehensive chart of accounts and related account definitions consistent with the Accounting Manual submitted by each contractor for approval by the Authority. It was pointed out that it was important that

the accounts be consistent with non-discriminatory accounting procedures while the harmonization of revenue and the principle of non-discrimination would serve both the interests of the Authority and those of the contractor.

17. Another view expressed was that, although the contractor would be obliged to submit the Accounting Manual for approval within 60 days of the effective date of the contract to the Authority, subsequent articles contained no time-frame within which the Authority should respond. To remedy this omission it was proposed that if the Authority did not state its views on the documents within 60 days of the date of their submission they would be considered approved.

18. Another issue raised was in regard to the keeping of books at each contractor's principal place of business. Views were expressed that the language of the draft article would give rise to varying interpretations and it was suggested that the language be modified to avoid such interpretations.

Article 141. Accounting for materials and supplies

19. Several views were expressed on this article. It was stated that it would not be objective to fix percentages for the price of new and used material and that any references to percentages should be deleted, including the percentages used to define "significant gain or loss".

20. Another view was that the term "costs actually paid" should be changed to "costs actually charged".

21. A question was raised as to the need for categorizing the materials as new, used or that which could not be classified, and it was suggested that the price of the material could exceed its value and that the percentages contained in the draft regulations might prove to be too high. Another view was that the use of the term "if feasible" should be deleted and that rather than requesting "reasonable explanations" only "factual explanations" should be required.

Article 142. Accounting for equipment

22. It was suggested that a distinction should be made between "controllable materials" and "physical assets" and that a definition of "physical assets" might be required to be included in article 2 on the use of terms.

23. Another view was that the period of five years was considered long for the contractor to conduct a physical inventory of capitalized physical assets and that a shorter inventory period would be preferable.

24. A further view was that there was no need for the Authority to be involved in the preparation of a physical inventory since only an accountant was required for its preparation.

Article 143. Personnel costs

25. It was proposed that the term "net" should replace the word "gross" in regard to salaries to better reflect costs to the contractor. Furthermore, references to costs for holiday, vacation, sickness and disability payments should be preceded by the phrase "other costs directly incurred in operations under the contract such as ...".

26. A different view was that the term "gross" should be retained in regard to salaries. It was also pointed out that the percentage of taxation was of no relevance to the Authority.

Article 144. Charges for training programmes for personnel of the Authority and developing States

27. It was suggested that the draft article gave the impression that training would be provided free of charge by the contractor and that the Convention did not provide for such an arrangement. The suggestion was then made that if contractors were to provide any training it should be charged to the Authority.

28. A view was expressed that the article should provide for practical programmes for the training of personnel of the Authority or of developing States. It should also provide for the participation of developing States in all activities in the Area covered by the contract.

29. A further view was that "charges" were not defined in the Convention, which only provided for "principles", and that according to the Convention the contractor was required to include the participation of nationals of neighbouring developing States.

30. Another view was that the obligation to undertake measures to advance the domestic technology of developing countries included providing training opportunities. It was also pointed out that the expenses for such training should be deducted from the share of proceeds attributed to the Authority.

Article 145. Charges for transfer of data to the Authority

31. It was proposed that the draft article should be preceded by a new text establishing the obligation of the contractor to transfer technology. It was also suggested that the article should be amended to apply to all contractors and not just to those who had opted for the mixed system, i.e., the combination of a production charge and a share of net proceeds. The amendment proposed was that "costs for the transfer of technology by the contractor to the Enterprise in respect of the area covered by the contract shall be charged in the event the contractor is requested to acquire from the owner of the technology the legal right to transfer to the Enterprise any technology used by the contractor in carrying out activities in respect of the area covered by the contract which he is not otherwise legally entitled to transfer."

32. Another view was that the proposed amendment contained problems since the Convention called for the transfer of technology under "fair and reasonable

commercial terms and conditions" and if accepted the proposed amendment would contravene the provisions of the Convention in that regard.

33. On the other hand it was pointed out that this objection to the amendment viewed the transfer of technology from a commercial context. The proposed amendment did not concern itself with commercial exchange; it was only concerned with issues of deductible costs. If such costs were paid, this would be reflected under income and expenditures and not as a charge.

Article 146. Charges for third-party contracts

34. It was proposed to amend the article to reflect that the charges for comparable working services resulted from competitive bidding among potential suppliers. An additional new paragraph was proposed to provide that "the policies followed by the contractor with regard to determining the prices for transactions undertaken with any person, firm or company that, directly or indirectly, controls, is controlled by or is under the common control with a contractor shall be disclosed in the financial reports submitted by the contractor to the Authority".

35. It was pointed out however that the article should be limited to mentioning that third party costs should be charged since it is within the management's responsibility to decide on the actions necessary to ensure optimum revenues for the contractor and thus for the Authority.

Article 147. Charges for affiliates

36. The view was expressed that it was the obligation of each contractor to ensure optimum revenue for itself and to try to make better profits than competitors.

Article 148. Rental payments

37. The view was expressed that the draft article restricted the contractor's discretion with regard to interest to be paid by the contractor for development costs and for operating costs and thus it should be deleted. However, it was also suggested that the draft article be retained since it was possible for profits to be disguised as rental payments to the detriment of the Authority.

Article 149. Insurance costs and losses

38. It was pointed out that the second part of the article presented difficulties and that if losses occurred they should be charged, irrespective of the reason for their occurrence. Furthermore, no judgement of misconduct should be made. It was suggested that a contractor should also be entitled at any time to close down the project, and if he did so he should not be required to pay fees.

39. A different view was that it would seem strange that a contractor engaged in an act with predictable negative consequences would be allowed to profit

from his indiscretions. It was stressed that no person should take advantage of his mistakes or use them as a defence. It was proposed therefore that contractors would have to accept a measure of responsibility, particularly for wilful acts causing environmental damage, and should not be allowed to charge costs for any resulting clean-up.

Article 150. Legal costs

40. It was pointed out that the evaluation of legal costs could not be done by those outside of management and that any reference to "fairness and reasonableness" should be deleted. Furthermore, legal costs occurring prior to the effective date of the contract, but which were directly related to the operation of the contract, should be deductible. It was also stated that there was no need to authorize the Authority to examine the requirement for legal fees and that only the contractor should establish whether or not such a need existed. On the other hand it was pointed out that the text on legal costs should be re-examined since it referred to "fair and reasonable costs".

41. A view was also expressed that there was some merit for charging costs related to the contract if they had been incurred prior to its effective date. However, the discretion to decide as to whether legal costs arose from necessary, as opposed to unrelated, services should not be left to the contractor. It was claimed that if the article were deleted the contractor could charge all legal costs to the Authority.

Article 151. Overhead and administrative costs

42. It was proposed that the draft article be amended to state that overhead costs incurred after the effective date of the contract were to be charged in accordance with a specific percentage to be agreed upon between the Authority and the contractor. It was also proposed that "rates" referred to in the text should be specifically addressed as "agreed upon rates". In addition the term "wilful misconduct" should supplement references to "negligence". However, another view expressed was that the current wording of the draft article did not adequately differentiate between contractors choosing only a production charge and those who had chosen the mixed system. It was also proposed that the reference to "negligence" should be deleted.

43. A further view was that the amendments proposed contained an element of elasticity which would enable appropriate adjustments to be made. The amendments provided room for negotiations between the Authority and the contractor with respect to overhead costs incurred. However, another view was that there was no room for negotiations between the contractor and the Authority in most cases, and particularly in this article the contractor had no room at all for negotiations.

Article 154. Financial reports

44. It was proposed that the article should be clarified to include a text stating that "each quarterly report shall be prepared on a monthly and

aggregate basis and shall be sent to the Authority within 45 days after the end of each quarter. The Authority may make comments and propose adjustments to any report provided that such comments and proposed adjustments are made in writing within six months from the date of submission of a quarterly report". Another proposed amendment was in reference to the annual report, and it was proposed that the Authority "may make comments and propose adjustments provided that such comments and proposed adjustments are made in writing within five years from the date of submission of the report".

45. On the other hand it was pointed out that the draft article could be characterized as falling into the realm of over-regulation and contained excessively onerous provisions. For instance, the necessity of quarterly reports had not been demonstrated and annual reports should suffice. The use of a profit-and-loss statement might seem appropriate but the same did not apply to the statement of cash flow and other provisions. Furthermore, the projected budget statement would also be inappropriate since much of it would be confidential. It was proposed that the provision for five years for comment by the Authority was too long and should be replaced by a provision for one year.

Article 155. Inspection and audit

46. A proposal was made that the text should specify that an annual audit should be undertaken by reputable and independent auditors at the expense of the contractor. The Authority, at its own expense, should be able to designate reputable and independent accountants to conduct additional audits if special circumstances should warrant it. It was also proposed that an extra audit be carried out, at the contractor's cost and at the request of the Authority, if the contractor's reports had been found to be inaccurate or incomplete. Furthermore, the accountants designated by the Authority should have the right to conduct inspections in connection with the contract.

47. A different view expressed was that the audit should be conducted by recognized auditors in accordance with internationally recognized auditing standards.

48. It was pointed out, however, that there was no justification for the right of accountants to conduct inspections and that this provision was excessive in that regard and should be deleted. In the event this right was retained, then all inspections should be limited to those sites directly used by the contractor.

Article 156. Retention of books, records and documents

49. It was proposed that the text should be amended to provide that all books, records and documents shall be maintained for a period commensurate with the useful life of the equipment and material used by the contractor and, in any event, for not less than seven years from the date of issue. However, it was pointed out that this amendment introduced a degree of uncertainty regarding the duration for which books and records must be maintained. It was

stressed that it was important to specify the exact length of the period required.

Article 157. Application of these regulations to the Enterprise

50. It was proposed that the phrase "mutatis mutandis" should be deleted since the Enterprise must conform to the reporting rules for net proceeds without exception. It was also pointed out that the Enterprise would need a comprehensive financial accounting system and its management might wish to choose among existing systems.

51. Following the completion of the consideration of LOS/PCN/SCN.3/WP.6/Add.7 in the informal working group of the whole, the Chairman conducted informal open-ended consultations to ascertain areas of agreement and disagreement on the paper.

52. There was general agreement amongst delegations that it would be necessary to ensure through these regulations that the International Seabed Authority gained the financial benefits to which it was entitled under the relevant provisions of the Law of the Sea Convention. There was less unanimity as to the precise scope and structure of a revised version of LOS/PCN/SCN.3/WP.6/Add.7. Several delegates expressed the view that they were not in a position at the current stage to put forward concrete drafting proposals, as such proposals would require advice from experts from their home capitals.

53. Delegates therefore proposed that the Chairman undertake the task of preparing a revised version of the working paper. He intends to do this after receipt of concrete proposals from all interested delegations and after further consultations and discussions with delegations during the coming session. In this context, certain delegations which have not yet put forward concrete drafting proposals undertook to do so in the period before the spring session in 1992.

## III. PROGRAMME OF WORK AT FUTURE SESSIONS

54. During the spring session in 1992 the Special Commission will conclude its consideration of document LOS/PCN/SCN.3/WP.6/Add.7 as quickly as possible. To this end the first week of the coming session will be devoted to intensive consideration of that working paper. The assistance of experts from capitals during the first week would be of utility for all delegates.

55. The Special Commission will then consider two new working papers to be prepared by the Secretariat on inspection and supervision of activities in the Area and on labour matters. Those documents will be circulated to delegations well before the commencement of the spring session so that they may prepare themselves for discussion.

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